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Re-examining Truth in Lending: Do Borrowers Actually Use Consumer Disclosures?

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Re-Examining Truth in Do Borrowers Actual Consumer Disclosu

*A panel discussion at the ABA Section of Business Law, Committee on Consumer Financial Services 1997 Spring Meeting, Boston, April 5, 1997**

Speakers: Ralph J. Rohner, Professor of Law, The Catholic University of America, Washington, D.C. (moderator); Robert A. Cook, partner, Hudson Cook, LLP, Crofton, MD; Robert F. Elliott, President, Household Finance Company, Prospect Heights, IL; Kathleen E. Keest, Assistant Attorney General & Deputy Credit Code Administrator, Des Moines, IA; Nina Simon, staff attorney, AARP Litigation, Washington, D.C.

Dwight Golann (Chair, Committee on Consumer Financial Services): For some years I've had this guilty feeling because I never read the disclosure documents from my last mortgage refinancing, or any of the refinancings before that either. There's this pile of disclosure papers at home; I keep them just in case. Recently I finally pulled them out, thinking I should read a few. But I got only as far as a full-page disclosure of the transfer of mortgage servicing rights before I decided I can't take this any more. So I thought, if I don't read this stuff, how many other people do? And that led to a question about the whole regime of consumer credit disclosures. It so happens that the Federal Reserve Board has been charged by Congress with taking a look at disclosures for mortgage transactions in particular,[1] and the Board may be thinking they need new legislation to do some of the simplification they are planning. This, then, seemed a very opportune moment to pull together a panel of people from industry, including an executive from a large company that grants consumer credit, and consumer representatives. I asked Ralph Rohner, who participated in the earlier Truth in Lending simplification process, to preside over the discussion.

Ralph Rohner: Thank you very much. The question in the program book is posed, **"Do borrowers actually use [credit cost] disclosures?"** and the subset to that caption is **"and if not, why not and what can be done about it?"** A week or so ago a headline in the press reported that, according to a study, 40% of mortgage borrowers don't comprehend settlement information. Well, one could ask about that headline: Is the glass half full or half empty, or maybe 40% empty and 60% full, because the intimation is that 60% of consumers must have comprehended the settlement information. This panel does not propose to debate statistics. Rather we'll try to provoke you and each other to think why disclosures aren't more effective, whether they can be improved, and how. To set the stage for that presentation and with the permission of Stephen Spielberg, we thought we would stage a brief tableaux to suggest our relative positions on these issues. Members of the cast...[appearances in Star Wars regalia, with sound track].

[applause].

Our mode of progression is this. The panelists will take three or four minutes each to give a brief rifle-shot statement of their perspective on the general question of "Do borrowers use disclosures? If not, why not and what can be done about it?" Then we'll proceed by my posing questions to the panel as a whole or to individual members. I hope that provokes an exchange among us that in turn provokes some questions and comments from you in the audience. We will save ten or fifteen minutes at the end so that if you have comments or questions you can add or ask them then. But if you are overwhelmed by something that is said up here and feel the uncontrollable need to interject a question or comment, please do so and we will take you on.

There is no particular priority or other structure to the order of presentation but let me ask Robert Cook, first, to make an initial statement.

Robert Cook: My perspective is from somebody who has spent most of his professional life drafting disclosures that I feel are never read by consumers and, in truth, do very little to educate consumers about the cost of credit. From my perspective, the people that read the disclosures that I help develop are plaintiffs' attorneys and it is plaintiffs' attorneys that put them to use, for good or evil.

What I see as the evil empire out there is the fact that we have a disclosure statute designed to educate consumers being used for a purpose for which I believe it was never fully intended, and that is to fight consumer fraud. There are consumer fraud statutes on the books and there are available methods to fight consumer fraud, but consumer fraud claims should not be filed because somebody in the closing process made a $15 mistake on the HUD-1 settlement statement. My prime example of this is, of course, the

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1. Section 2101 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, Pub. L. 104-208, 110 Stat. 3009 (1996), directs the Board and HUD to simplify and improve the disclosures given in home mortgage transactions subject to the Truth in Lending Act and the Real Estate Settlement Procedures Act.

Rodash case.[2] The *Rodash* case was a matter of a lady who got taken by a couple of crooks, and she got some justice that she deserved but not in the way that it should have happened. Let me ask you, if she had been given correct Truth in Lending disclosures, according to the 11th Circuit, do you think it would have mattered to her whether the Florida recordation tax had been included in the finance charge? I don't think so. Every other lender she went to would have included the tax in the finance charge. It would have made no difference to her. Do you think that a $15 Federal Express fee that was disclosed to her and was included in the amount financed but not in the finance charge would have made a difference to Mrs. Rodash? I don't think so. Most of the lawsuits that we see involve technical mistakes with disclosures that have no practical meaning to the consumer.

Rohner: Thank you, Robert. Kathleen Keest is in the corner of the room by the overhead projector.

Kathleen Keest:[3] I want to set the stage by doing some audio-visual here. This [first overhead] is from a study that the Department of Education did.[4] It was a study of functional literacy, so they included document interpretation and quantitative skills along with reading skills. This was an ad for a home equity loan that appeared in the newspaper.

Fixed Rate * Fixed Term

Home Equity Loans

14.25%

Annual Percentage Rate

Ten Year Term

Sample Monthly Repayment Schedule

Amount Financed	Monthly Payment
$10,000	$156.77
$25,000	$391.93
$40,000	$627.09

120 Months 14.25% APR

The interviewers asked consumers to read the ad and explain to the interviewer how they would compute the total of interest charges for the loan.[5] Nina [Simon] told me she had to get out her calculator to try to figure it out. Actually what you have to do is just take the monthly payment, which is $156, times 120 months and subtract the original principal of $10,000. That was what the test question was. The result of that survey of consumer literacy was that only 4% of the American adults interviewed could do that calculation, and most of those 4% were people with at least some college education. With that in mind as the baseline of what kind of level of complexity people can actually interpret, I want to ask a question. How badly do some of us, some creditors anyway, want people to understand?

This [second overhead, *not shown here*] is a disclosure that was given in conjunction with a door-to-door home improvement sale. It is the open-end credit card disclosure given to someone who is about to make a $9,000 purchase. I think you can probably see that most people's eyes would just glaze over, pretty much immediately. Even if they did read it, what it says down here in paragraph number six is the minimum monthly payment is 1/55th of the balance,[6] and here is how the finance charge is computed, and so on. A closed-end translation of that language means a consumer could pay $17,000 for $9,000 worth of porch repairs.

[THE NEXT EXHIBIT (top of page 5) SHOWS THE INFORMATION THE CONSUMER WOULD HAVE TO BE GIVEN IF THIS $9,000 HOME IMPROVEMENT LOAN WERE A CLOSED-END TRANSACTION.]

2. Rodash v. AIB Mortgage Co., 16 F.3d 1142 (11th Cir. 1994). *See* Robert A. Cook, *The Truth in Lending Act—A Review in Light of Its Original Purpose*, 49 Consumer Fin. L. Q. Rep. 357 (1995).

3. *Cf.*, Kathleen E. Keest, *Whither Now? Truth in Lending in Transition—Again*, 49 Consumer Fin. L. Q. Rep. 360 (1995).

4. "Adult Literacy in America," National Center for Education Statistics, U.S. Dept. of Ed. (Sept. 1993), at 100.

5. The question posed was this: You need to borrow $10,000. Find the ad for Home Equity Loans on page 2 in the newspaper provided. Explain to the interviewer how you would compute the total amount of interest charges you would pay under this loan plan. *Id.*

6. The contract, in very small print, said that the monthly payment is 1/55th of the initial balance, recalculated when [and if] there are additional purchases.

Annual Percentage Rate The cost of your credit as a yearly rate.	**Finance Charge** The dollar amount your credit will cost you.	**Amount Financed** The amount of credit provided to you or on your behalf.	**Total of Payments** The amount you will have paid after you have made all payments as scheduled.
16.99%	$8,554.25	$9,000	$17,554.25
106 pmts. @ $163.64 per month, beginning [__date__] + 1 final @ $208.41 on [__date__]			

People who do these kinds of home improvement contracts know how to lower prices to make the sale, and I think a lot of people—if given this information—would look at the difference from $9,000 to $17,000 and maybe say, "No thank you."

Here is another example [*not shown here*]. Fingerhut is a retail merchant that offers goods through catalogues. Their target market, their president was quoted in *American Banker* as saying, is the "third bucket," the lowest of the three economic tiers: those customers are not value sensitive, they are not interest rate sensitive, and they are not fee sensitive. So, having decided that customers are not sensitive to any of these things, this is the way Fingerhut does its pricing information. In their catalogue here—I happen to use this brand of cookie sheet, so I was interested—it says $4.89 per month for the cookie sheet and cake pan, and the pricing [disclosure] down here at the bottom says "See page 53." There you see that it's $29.99 or $4.89 per month. This is the way the price information is given in the catalogue. Of course the buyers get transaction specific disclosures after they have the stuff in their house, and if they don't want to go through with the deal they have to pack it all up and mail it back. But it's a 26 percent rate, well, 26.75 percent for those items indicated with the star or 25.50 percent for some others indicated with some other little bracket there.

Anyway my basic point is that there are a lot of disclosures out there that are probably not very consistent with the idea that anybody can understand them, nor are they really intended to be understood.

Rohner: Thank you, Kathleen. Bob Elliot, let me echo Dwight's welcome that you could be here. You are not a lawyer but you are welcome nonetheless — particularly your perspective as an executive of a major lender.

Robert Elliott: I told Dwight when he asked me about being a lawyer that my soul was unblemished. [laughter]

Customers do read disclosures. Let me adjust that: they read the numbers in the disclosure boxes. Prior to coming here I sat in on a couple of loan closings just to see what happens. These happened to be home equity line of credit disclosures for which the paperwork is quite extensive. It incorporates all those things that Dwight said he never reads and more. What the customer does focus on are certain parts of the disclosure and most prominently they focus on what the APR is, and the amount financed; also what the nature of the transaction is, whether it's variable-rate or fixed. They focus strongly on fees; any fees which are prominently displayed are read carefully. And they ask questions about things like prepayment penalties and late charges and those sort of things. But the most prominent thing they look at is "When is my payment due and how much is it?" As regards all of the rest of the verbiage, it receives no attention whatsoever and I think the reason is fairly straightforward. First of all there's an awful lot of it and the customer concludes (with some justice) that even if they read it, they would likely not get much information from it; they wouldn't understand it. It's not designed, as you just saw in a lot of these overheads, to be read by someone to gain understanding. It is most often designed to fulfill some sort of legal requirement to have it there in the first place. And the more pages you produce the more people's eyes glaze over. And what's the answer to that? I think the answer is simplification in terms of just focusing on what's truly important. The devil in the details is determining what is truly important and who's interpretation of what it really is should prevail.

Rohner: Thank you. Nina…

Nina Simon: We are all trying to get ourselves out of the mud and to rethink what we can do with disclosure. My premise, and I think Kathleen's, is that disclosure can be made easy, comprehensible and useful to the consumer. We hear a lot about consumers not shopping around for credit, that consumers don't read disclosures, that they're not useful to consumers. As my kids would say to me, "Well, duh, Mom." I also hear—which is somewhat inconsistent—that the industry wants consumers to shop. We all want consumers to shop and we want to figure out how to do that better because no consumer can understand the current system. Now, this may be somewhat radical, but the premise of my remarks is that consumers are entitled to know the cost of their loans. And they're entitled to know that at a time that is useful, that will allow them to shop and will encourage market competition. Right now the only time that a consumer can really shop, at least with a mortgage loan, is during the rescission period. I'm certainly not advocating that rescission approach for all credit and I don't think any of you would find that very useful. So, the issue is what can we do. We hope, and I'm going to assume, that the industry is also interested in promoting shopping and giving consumers real information. When you say that consumers don't shop, that's not really true. They do shop. They shop for lots of things. They shop for things where they can understand the pricing. They shop for food; they shop for televisions; they comparison-price things; they shop for computers. So, what we need to do is create a pricing mechanism for loans that allows consumers the same ability to shop; a simple, understandable price tag that they get early on, that they can use. I think that if the industry is truly interested in having consumers shop and in having consumers understand their transactions, that you all have the technical know-how and the money to create such a price tag. I'm not going to identify specifically what I would do. We've done that in our [AARP] comments [to the Federal Reserve Board] somewhat, but we're willing to be radical; we're willing to make changes. We want people to get something useful. Certainly one premise is that all the costs of the transaction need to be in the price tag and that anything that a consumer pays in the transaction is part of its cost no matter what we call it now.

It is also pretty clear that consumers weigh things, like convenience against price and service, and they make decisions all the time. Even a poor client, and certainly lots of moderate income consumers, might decide to buy a quart of milk at Seven-Eleven for the convenience instead of going a farther distance to a supermarket where the price is cheaper. But they can understand that decision, and in fact maybe that's even a more cost-effective decision if they're saving car fare. But the question is if you told a consumer that getting this loan is like buying all of their groceries at the Seven Eleven, how many people would do that? I don't think very many would and that's probably a good translation for a lot of the loans I see. It's like buying all your groceries at Tiffany's or something. I think that's the problem we have. We know that consumers shop at Shoppers Food Warehouse, Price Club and places like that. Those places are proliferating all over the country. If consumers have an ability to understand a transaction, I really believe they will shop. And if they do that, it will be better for the industry in the sense that it will wipe out a lot of deception. It will be pro-competitive. Everybody always says they want the market to work. We want the market to work to drive prices down and we think that that would do that. So, we're suggesting, think creatively, create an early simple accurate price disclosure and one that reflects all the costs.

Rohner: Without debating statistics about how many consumers gather how much enlightenment from how many disclosures, I think we all share a sense that the level of utility and understanding of the various disclosures in credit transactions is less than optimum. I want to pursue with the panel a further level of inquiry about that. Why? What is the source of the lack of effectively communicated information, or the lack of internalized and used information? There is lots of information on paper, disclosed or given to consumers in credit transactions. Is the failure, the breakdown of the utility of that information a function of the consumers, their educational levels, their psychological state, perhaps, at the time of the transaction? Or does it flow from the nature of the transactions that they are being asked to enter into, that is, inherently and increasingly complex transactions? Or is it a function of the legal regime, the Truth in Lending Act and related regulations? Robert Cook, let me throw that to you first.

Cook: I agree with Nina that one of the problems is that consumers are not getting useful information in a timely fashion. The detailed Truth in Lending disclosures generally are given at consummation and they cannot be used for shopping. Even the disclosures that are given on a home mortgage transaction within three days of application are generally given too late for the consumer to start shopping. By the time consumers have put in an application, they generally have decided which lender they are going to use. So if we are going to take Truth in Lending and mold it into a form that would be useful, we would want early disclosures and we would want them simple; they have to be simple if they are going to be useful. Right now, one of the reasons that consumers don't read them is that they're too complex. I often hear that the reason they're complex is because my clients develop complex products. But what has happened as we developed complex products: Truth in Lending hasn't changed and we've begun an intricate three-dimensional jigsaw puzzle of trying to fit the old Truth in Lending around the complex products that we're offering. What we need to do is develop a truth in lending disclosure that goes to the heart of the transactions and provides only the basic information that people need to shop for credit.

Rohner: Kathleen or Bob, do either of you want to react to that general question, as well. What is the source of the information failure? The consumers, the transaction, or the law?

Keest: All three.

Elliott: Kathleen said "all three" and I think that's true. The transactions are getting more complicated or at least they're different. That's another way of saying there's a lot more choice for consumers these days. And unfortunately, some of these transactions are not well understood or well explained by the lender when they do it. I will admit to you that we have a problem in that regard and it's not a disclosure problem but it's a real economic problem for us. It is very expensive today to originate a loan. In fact, it costs us almost as much to originate a home equity loan in the first place as it does to service and apply reserves to the ultimate credit loss risk over the life of it. So acquiring a loan and servicing a loan, the costs are about the same, even though one happens as a cash-on-cash transaction up front, and the other is servicing over the expected or anticipated life. Well, it turns out the anticipated life of most of those transactions, even though they would amortize notionally over fifteen years, is about four years.

This is just about enough time to make our profit hurdles—if the customer lasts four years—to amortize the origination cost. Every degree to which it's shortened impugns profitability. Every degree to which the time lengthens substantially improves profitability. It is in our interest to extend the life of the transaction. Working against that is the fact that anything that surprises the customer about the transaction, anything that he didn't understand up-front, forms the principal reason why we lose them early, why they go someplace else. Notwithstanding our understanding of this, and all of our efforts to get through to customers for a lot of the other reasons that have been described here, people don't listen during a loan closing. It makes a lot of sense to make what you disclose clearer and more inclusive so there are no surprises to the customer later, and to provide the disclosures early on, and I say that in particular when there is a third party involved. When there's a broker or some other financial intermediary involved that disclosure needs to be made early.

Rohner: I have another question that I'm immediately going to turn back to you, Bob. Kathleen earlier posed the question whether in all cases creditors really want to disclose accurately and fully. Let me recast that in a little more benign form. How does disclosure or compliance with disclosure laws fit into a creditor's calculation of marketing strategy and profitability concerns?

Elliott: We did a marketing experiment in our direct mail business about three years ago. We took the disclosures that are required by law and put them in the degree of prominence required by law, and then in a separate sample of the mailing we made the disclosures of things like APR, amount financed, time to repay hugely prominent in the front of the transaction. The response rates did not vary. I would tell you that laying it out up front has the benefit of allowing people to make reasonable choices. Hiding it in the back may make no difference in the initial response you get. But it does make a big difference in what you lose later on. We opt for the greatest amount of disclosure, and not from any sense of altruism. I would rather disclose than be regulated. Anything you want me to disclose I can accommodate. If I am more efficient than my competitor, I will be able to live with the results of having disclosed everything I do. Where I think the mistake would be made, is by failure to disclose adequately, creating an environment of re-regulation or preventing the issuance of certain products because they are too complex or whatever restriction you could put on the market. I think what's happened in the market of late because of deregulation is a huge blossoming of credit availability to all kinds of folks at all kinds of economic levels that didn't exist before. And I think that's a good thing, so I'd much rather disclose.

Rohner: Do either Kathleen or Nina want to react to that same question. From your areas of work, is there any sense of a strategy of obfuscation on the part of creditors that you've encountered?

Simon: There is some segment of the population that will not be helped no matter what we do. But I have clients who have been totally ripped off. In our *Mills* case, the client shopped. She shopped; she ended up with a terrible deal which she didn't understand, but when we deposed the broker in that case he complained to us that she was shopping and he knew that because he kept making credit inquiries and as long as she was shopping he wasn't going to lift one finger to find her financing for her loan. As soon as he figured out she was done shopping, then he made one phone call—to earn his eleven points fee—to one lender, to get her a 24% interest one year balloon loan. I challenge anybody to figure out from the disclosure documents she got that that was the nature of her loan. So clearly there is a lot of obfuscation. It's particularly targeted at illiterate and low income communities but it's a problem with everybody's loans.

Rohner: Robert or Kathleen, do you want to respond to that question?

Cook: Let me just make one point about one of the examples that Kathleen put up. That's the Fingerhut example. The quote from the businessman at Fingerhut was "We'll deal with the third bucket. These people are not price sensitive, not rate sensitive, not fee sensitive." With that type of business attitude, I would think that you would make all the disclosures in the world and toe the line on Truth in Lending because you know it's not going to have any effect on the consumers. Fingerhut's disclosures in their catalogues are exactly what Truth in Lending requires. It may not be helpful and it may not be informative, but Fingerhut has been told by the Federal Reserve Board and Congress, this is the way you do it. So I'm not so sure we can point our finger at people like Fingerhut and say they're obfuscating the price of their product because they are doing exactly what they've been told to do.

Keest: I just want to say that my boss, who is the [Iowa Credit] Code Administrator, and I have had the experience of sitting in loan closings where the person on the other side of the table pointed to the APR and said, "This isn't really your interest rate. This is just a number the government tells us we have to tell you." One of those loans was for the very first car I ever bought, in 1980. If you remember the interest rates in 1980, when he described the 17 percent APR, he said this is really an 8 percent loan. It wasn't really an 8 percent loan.

Rohner: If anecdotes are tolerable, I was told not 20 minutes ago by a member of this audience that in recent transactions of selling and then buying a home, he was instructed exactly as Kathleen described. Oh yes, there's an APR figure but disregard it, it has no relevance to the transaction, it does not reflect the cost of your credit.

Audience member: In high end home equity situations, I'm typically seeing between 30 and 50 sheets of paper in connection with the transaction. And of course the disclosure statement is usually about number 35 or 36. To what extent do you think that a legal reduction in the number of pieces of paper that could be presented to a consumer in that situation would make a difference in the ability of the consumer to use this information?

Cook: The Federal Reserve Board Consumer Advisory Council last year undertook a study of the documents at closing with an eye to make some suggestions about simplifying, clarifying and reducing them. What they found out was not surprising. The number of *federally required* disclosures in that package of 52 documents is about five. The paperwork that's being generated at closing doesn't all come from consumer credit disclosures, and Congress is not going to be able to do anything about the secondary mortgage market requirements that produce the other 47 documents. What could happen though would be to bring the required disclosures, the helpful disclosures, up front to the beginning of the transaction to give consumers a chance to review them when they're not at closing. That might make those disclosures meaningful.

Audience: Why don't you think that Congress could say that these redundant waivers and notices and riders, that aren't an essential part of the transaction, couldn't be a part of the transaction?

Rohner: It's not the congressional way.

Keest: They could design something, and you could give the credit cost disclosures at separate times. Our idea that you would get the relevant credit cost disclosure early enough that it wouldn't matter.

Audience: I honestly don't think that that's the big issue. I know that there's a lot of paper and it's a pain in the neck for the lender and the customer doesn't read them, but I don't think that's the problem. The problem is that you need some simplified language. If you could even have a summary sheet that summed up all the disclosure and said, OK, here, this is a loan. It's got a mortgage on your home. If you don't pay it could be foreclosed. This is the interest rate, etc., etc. You could get that, I think. A rational person should be able to design something that you could get on one piece of paper that deals with the specific transaction at the time it closes. And I'm all for that. Even if it incorporates some fees into the APR that hadn't been done before, I'm even all for that. As long as you can do it with some certainty. It's where you have to say well this might or might not happen and if it happens it's this, and if it doesn't happen it's that, that you begin to compound the complexity you were trying to avoid. But give a summary sheet that says, this is all the stuff you signed and this is what it really means to a human being.

Rohner: Let me expand that inquiry a bit. *De facto*, we are seeing a kind of segmentation of the consumer credit markets in various strata, horizontal and vertical. Credit cards versus mortgages and car loans versus equity lines, and even among customer groups, upscale customers versus lower income, young versus old and so on. Are there different consumer expectations and different disclosure needs in various segments of the marketplace? In other words, should we be thinking about separate or perhaps cumulative disclosure regimes?

Simon: I don't think so. I think you've got to figure out a price, a simple price disclosure, whether it looks like the federal box or it looks like something totally different, for the different products that somebody can use to shop. Just as somebody can shop for different television sets or computers that have different features on them, they should be able to shop for credit. And they really will shop for credit if they get something that is easy to use.

Elliott: I don't know if I totally agree with that. Disclosures on a credit card transaction are pretty straightforward and the risk to the consumer is the loss of their credit standing and whatever the law allows to get the money back if they default. It's quite different when somebody's putting their home up for security. As a matter of fact, we find that where we've simplified the process too much on a home equity closing, customers are frightened by that fact and like to see more formality and more time taken when they are taking an important step. So, there's not as much resistance to the cacophony of closing document noise that you get on a home equity transaction. There is a great deal of resistance to it when you apply it on an unsecured or credit card transaction.

Audience: Simplifying disclosure gets more difficult the more complex the transactions become. You have to make decisions not only about what details to leave out but also about how to summarize it in such a way that it is both accessible to the consumer and somewhat accurate. And the accuracy problem becomes worse and worse the more complex it is and the simpler you try to make it to the point where you end up saying, "This may do this, and it may not, and if it does it might be important to you, and might not, but this disclosure might not be accurate in your case." You end up with these very arcane and useless pieces of disclosure.

Simon: I think that somebody could develop computer programs where you could plug in a few variables and generate a pretty simple document. Why can't you give people choices? For example, consider credit insurance. You could give consumers a price and an APR with credit insurance and it might say 126% APR with the credit insurance, 36% without, which one do you want? Or other variables like that. Settlement costs would have to be in there, so there would be an incentive for the lender to find a very reasonable settlement package that they could offer. They could say the settlement costs are X percent or $400 and they're figured into the cost of your loan. Maybe we won't itemize them, maybe we won't tell you the loan doc prep fee, whatever it is, but we'll tell you that this $400 will cover all of your attorneys' fees and all your closing costs and any appraisals, they're rolled into this number. You can shop it if you want or you can take our deal. I think that lenders have a lot of sophistication and they can develop programs so that people who are not sophisticated could input the numbers and give you a pretty accurate price. I just don't think that there's the will.

Rohner: Nina, do you hold out that same hope for reducing things to a simple set of numbers in both closed-end and open-end contexts?

Simon: Well, let Kathleen address that.

Keest: I don't have a concrete proposal, but I think that there are a lot of incentives built into the system for lenders to start moving to the open-end model. As you can tell from those two examples that I showed, one is that in open-end transactions consumers don't get as much bottom line price information as in closed-end. When the open-end rules of TILA were drafted it was for legitimate reasons, but I think it's being abused now. Two, bankruptcy priorities give creditors some incentives to do more open end credit. Exemptions from the Home Ownership Equity Protection Act, HOEPA, gives them some incentives to do it. Right now the market is trending toward more open-end credit which means less informed credit, I think, for a large segment of the population when it's being used inappropriately. I would like to see us try to meet the legitimate disclosure needs for legitimate open-end credit, but give people as much of the closed-end disclosures as we can as we do that. Earlier Bob [Elliott] said that when consumers are looking at the transactions, they do look at the items in the closed-end federal box, the APR, the finance charge, and amount financed. When the Federal Rerserve Board was reviewing open-end credit, we took a stab at drafting a document that would take some of the useful closed-end concepts that translated to legitimate open-end stuff. It was certainly not perfect, but I think you could work on a merger of closed- and open-end disclosures that might be useful all the way around.

Audience: I agree with Mr. Elliott that there is a difference between a mortgage and something like a credit card, which is a little bit more straightforward. Well I'm not sure about the Fingerhut thing. I do get that catalogue. I'm apparently part of that "third bucket." [laughter] You know, I was about to order something; I'm going to have to look at it again. [laughter]

Keest: Hey, you get nine months to pay for your cookie sheet!

Audience: But, as to mortgages, in spite of what people said here today, when you say that this is the real interest rate, that is a legitimate statement for a mortgage because people shop and they're comparing interest rates and points and they're weighing it for different reasons and combinations. There are a lot of reasons why one would decide, including looking at the interest rate rather than the APR, and that may be the best way, in some cases, to compare mortgages. I went to a closing with my sister. She was buying a condo, developer-financed, and it was a very good rate, you know, first year three and a half percent. Got to closing and there are no Truth in Lending documents and I said, "Where are they?" They said, "Oh, we're exempt, we're not a bank." [laughter] "We don't sell on the secondary mortgage. Our rates are so low that we're exempt." That was the bottom line. [laughter] But we did go ahead with the closing. We went through all the documents and she was comfortable. There probably was enough information there for her to know what she was getting, that she was getting what she had bargained for. I'm not sure the Fed box would help in that case. It was an adjustable rate mortgage that ballooned after seven years and that was all very obvious. I don't know that the Fed box would have helped. Is that a solution for mortgages—just disclose an interest rate and then give the HUD-1, where you have a total for your non-interest costs, instead of an APR?

Simon: Actually, in our recent comments to the Fed we did talk about having three things: here's your amount financed, here's your finance charge, your finance charge consists of interest over time and all of your upfront charges. Well, we proposed getting rid of the HUD form that you get early and also at closing.

Audience: What's wrong with good faith estimates?

Simon: Well, you guys have been complaining about all these disclosures you have to send out. You send out the RESPA good faith estimates,[7] and you have to do the Truth in Lending early disclosures, and then you have to do a HUD-1, and you have to do another Truth in Lending disclosure at closing. Frankly I don't find those good faith estimates very helpful because they're not very specific. Instead, you can show people how you get the numbers, how you get this APR because they're looking at everything that goes into it. This is what's in there and that's what creates this APR number and this is what's in the other number, and so on..

Audience: Sounds very complicated.

Simon: It's a lot simpler than what you have now. It could be simpler; that was just one proposal.

Rohner: I want to shift directions a bit. Much of our conversation so far has stressed the value of the disclosures, if they work, as guides or aids to shopping. Bob, you said earlier that from your perspective, you'd always rather disclose anything, than have it subject to regulation. In other words, you want freedom of action in constructing your products and marketing them. I wonder if there are reactions to that thesis. Is it possible that we are asking the Truth in Lending disclosure scheme to do too much, to serve as general policeman for more substantive abuses that may lie behind and be undetectable despite disclosures. Kathleen, do you want to react to that?

Keest: I have very strong feelings about that.

Rohner: That's why I asked you. [laughter]

Keest: When Truth in Lending was written, disclosure was an adjunct to a system of substantive regulation that was from a time when we thought that price gouging in credit had a moral component to it. Over the course of the last 25 years we have switched to, "Hey, let's disclose everything and then the market will take care of the abuses." The market will if the market is working like gravity. All over we've had legislative battles saying we can deregulate everything. Here's where I think the market segmentation issue is really significant because I think the market does work in some areas of credit and there are other areas where it just doesn't. There's a lot of sucker pricing going on which is also where the abuses in disclosure goes on. But then industry comes back and says, "Hey, let's just take care of everything with disclosure." For a lot of reasons, partly because of the literacy level of the consumers that you're talking about in the sucker-pricing target market, and partly because of the unwillingness of some of the lenders that operate in that market, it just isn't

7. Estimates of closing costs, required under the Real Estate Settlement Procedures Act.

going to work. This rationalization that we can deregulate everything in all circumstances and just substitute disclosure, I think is not working.

Cook: I have a slightly different thought than Kathleen, but I agree with her that we are asking Regulation Z to do too much. From my vantage point I see what Regulation Z is being used for, and it is being used by the plaintiffs' attorneys. These things all start with a case like *Rodash*, which has horrible facts. This woman was taken advantage of. But the judge, in attempting to do a good thing for that person, created a rule of law that would have all but ruined the mortgage industry in this country if it had been allowed to run to fruition. And that's a problem. That's not what our disclosure statements should be all about. Disclosures should be designed to help people understand transactions to the extent possible. And then we should rely upon consumer fraud laws and general tort theories to deal with the people who have taken advantage of Nina's clients. In the two cases I dealt with with Nina, one actually on her side and one helping a holder of a note work out of a very difficult situation, both problems dealt with "relative fraud." Older people were taken advantage of by younger relatives. There is no amount of disclosure and probably no amount of substantive law that's going to protect those people in the first instance.

Simon: Of course they were not just taken advantage of by the younger relatives. It was done with a very open-eyed aid and assistance of the brokers; they were both brokers and settlement attorneys in fact.

Audience: I'm struck by a couple of things. First of all, we're having this debate as if Truth in Lending should have been cast perfectly 25 years ago and not have needed to be changed. One of the reasons that people don't mind the Fed box is because it was designed by, in large measure, a behavioral specialist twenty years ago to deal with this notion of "information overload." Moreover, we're neglecting, I think, some of the political process. We just got rid of a fifteen year ARM index disclosure. Now why did we ever have that? Because that was the price that the industry had to pay basically to get regulatory approval to do variable rate mortgage loans. And we were looking for variable rate mortgage loans just after we'd gotten out of double digit hyperinflation where the rates had gone up very, very high and therefore, it made sense, in 1984 or 1985 to have this elaborate index. It was a simple price to pay. It now seems absurd when we've had ten years of relative lack of inflation without widely gyrating rates. So, obviously it was logical for it to be dispensed with. As to the Fingerhut ad we were looking at earlier, the catalogue makers were told to use the Truth in Lending disclosures not last year, but in 1969 when those regulations were developed. The simple point, I think, of all of this is that these regs and the law probably ought to be re-addressed on a minimum of once every ten years rather than once every twenty years. And secondly, we have to recognize that there are political trade-offs and many of the more complicated disclosures we're forced to get into were the result of very hard fought compromises, not that the industry was prepared to disclose everything but just in terms of getting regulatory approval, to pre-empt state law and to allow for a secondary market to develop to allow for flexibility in financing in this very dynamic field.

Rohner: Let me expand the question a bit to the panel and the group. What if you start thinking, in an iconoclastic way, that we ought not be hamstrung or shackled forever by constructs in the current law. Consider, in fact, what's happened: we "simplified" TILA once upon a time, a dozen, fifteen years ago and quickly recomplicated it over the next decade.

Audience: When we simplified closed-end credit and got a federal box, we could very easily have simplified open-end credit and got a federal box. We did to some degree with advanced credit card disclosures. But the squeaky wheel was not in open-end credit, it was in closed-end credit. That's where, in that day and age, plaintiff attorneys were using Truth in Lending to get their clients out of trouble with creditors.

Rohner: Well, I never quite got to make my own personal opening statement on the merits. Let me interject that, parenthetically, here at the moment. I'll keep to the shortest version possible of it[8] ...

Audience: Ralph, I was going to ask you about what ever happened at Truth in Lending simplification, because you had a story, I think, about being at the front of a whole auditorium full of lenders and what all, trying to orchestrate this. Would you cover why it didn't get simplified?

Rohner: You give me much more credit or blame than I honestly deserve. [laughter] There's no point talking history stories here particularly. We all ought to be very careful or, that's the wrong word, suspicious of feeling bound to constructs and notions that are currently in Truth in Lending, however comfortable they may have become over thirty years, when in fact the impelling force that puts the structure in place, that is basically still there, is the closed-end, open-end distinction, the monolithic building up from or to an APR and finance charge that are the critical building blocks. All those basic structural components of Truth in Lending were dictated by members of Congress and lobbyists, without benefit of any particular field study or assessment of what kind of information in what form could really be useful to consumers. We ought not slam the door on the possibility of thinking afresh of an awful lot of what is currently in the Act. Kathleen [Keest] was talking in that same general direction a few minutes ago. Maybe my question out of all that is "How likely is it, how willing might we be to rethink what have come to be, or might otherwise be, immutable foundational concepts of the current disclosure regime?" Anybody have a reaction to that? Robert? Bob?

Elliott: That's more question than I know the answer to. I think it's clear that the disclosures that were designed for closed-end have been subsumed by the

8. *Cf.* Ralph J. Rohner, *Whither Truth in Lending?*, 50 Consumer Fin. L. Q. Rep.114 (1996).

fact that most of the credit transactions going on these days are open-end, and the trend is to more and more open-end credit. It has a lot of attractiveness both for the lender and for the buyer. It is a much more efficient transaction and therefore I think you probably should redesign the whole notion from the perspective of open-end transactions. The reasons that some of the worst offenses continue to exist in things like loan flipping are largely an attempt to make a closed-end transaction open-ended in its profit production. And that is an area that I agree very much with consumer advocates that's in need of being addressed. The gentleman over here who commented on the fact that the whole process needs to be dynamic is absolutely correct. The good news is that nothing really terrible has happened so far. I mean there have been some strange things like *Rodash* but they quickly got addressed. If you've got nasty facts, you deserve to get whacked and if you have made a mistake, and it's a legitimate one, people will generally recognize it was a legitimate mistake and if there was no harm, there's no foul. When I asked my general counsel before I came here what she thought about changes to TILA and simplification and so forth, she says, "Leave the bloody thing alone. You know we're just beginning to understand it and know how to react and we've organized ourselves to deal with it. And we think it works just fine though occasionally it ought to be adjusted."

Simon: I would like to respond strenuously to that. Nothing terrible has happened to the industry and probably nothing ever will because you will run to Congress and get it fixed like you've been doing. But terrible things happen to consumers and they're not necessarily all in your interest. Consumers are getting into loans that they can't afford, that they don't understand and they lose their homes, they lose their cars. Neighborhoods get destabilized, especially when certain kinds of lenders go into certain neighborhoods and basically sell all kinds of loans that will have the effect of causing foreclosures. Consumers are being harmed and if you went to the RESPA hearings you would hear that even wealthy consumers are being harmed by deception and by lack of information, by not understanding their transaction. So, I think it is very important to reform or rethink the concept of disclosure so that disclosures can be written for the people who are supposed to benefit from them and not for the industry.

Cook: You know, I fear I'm beginning to sound like a harpy here. Maybe I do need that Darth Vader hat now. [laughter]

Nina works in a different universe. Nina fights the dark forces every day. And God bless her that somebody's out there doing that. But I again will submit that the problems that Nina's clients face are not because they failed to get accurate disclosures. And to echo what Bob's general counsel said about let's just leave it alone, I hear that more and more when I talk to in-house counsel. They've seen simplification before. They've seen changes in Regulation Z. And while I would love to revise that statute, to make it a meaningful, credit-shopping tool, I don't think it's going to happen, and I think if we try, we're likely to get more difficult regulations and more penalties imposed because of silly mistakes that are made in the process.

Keest: In theory I don't disagree with some of that. In practice what happens is that you try to take those consumer frauds to court as unfair or deceptive practices, and a lot of judges say, "The law doesn't require that we disclose to you that we've screwed you in this way, therefore your remedy is to go to Congress." What you are left with is a totally uneven batch of remedies which are largely in the eye of the beholder. And a lot of people just say, "Hey, they signed the papers; that's too bad." If we are going to have disclosure stand as the substitute and the definition for what's supposed to be policing the market, then I agree with you that Truth in Lending is sometimes just a surrogate to get at deeper problems. But when the law has left all the substantive regulations so that you've got this "eye of the beholder" approach to whether something was unfair or not, that's why consumers and their lawyers turn to the disclosure. You know, we can't leave Truth in Lending alone without recognizing that huge hole over here on the other side.

Audience: Someone told me that as the Truth in Lending simplification discussions went on, the advocates asked for evermore complex and thorough disclosures and one cynical person said that the industry said, "No one's going to read them anyway, so if that makes them happy, why not?," and we ended up with a very complex set of disclosures apart from the federal box. Is that an accurate statement of the dynamic of what happened a number of years ago? And if so, I do see a different consensus forming now about the utility of simplicity. I see that the continuing tension between if you're going to make it apply the right way to every particular situation, it's going to have to be complex and there is going to be a tradeoff between simplicity and precise coverage. But on the issue of the virtues of simplicity, have things changed since 1981?

Rohner: I'm not sure I trust my memory wholly, and there are other people around this room who participated quite actively in that process. My instinctive reaction is that that effort began obviously with some push from some members of Congress who were screaming about the need to simplify and so on because they were hearing it from constituents. But it began, especially the Federal Reserve Board staff exercise, as a genuine effort to see if there weren't ways to streamline some of those disclosure details that the courts had been construing in increasingly complex ways. There was also, I think, an intention to kill off a lot of the litigation, to get clear rules that would do so. Almost all the focus was on the closed-end side, very little on the open-end side. So, I think it was a genuine effort to simplify, but very modest in its scope. And of course Congress within years began adding on new titles of disclosure for new transaction patterns.

Audience: It may be helpful to recall that the time of simplification in 1980 coincided with a time when Congress and industry were very down on the Federal Trade Commission and considering a number of very restrictive amendments to the FTC Act. That was the political climate at the time of Truth in Lending simplification. I had anticipated, and I think correctly, that with the removal of Truth in Lending as a cure-all for anything that was wrong with a consumer transaction, that more focus would be turned on the substantive problems that arise in connection with consumer transactions. I don't know if there is a cause and effect relationship, but since 1980 there's been an explosion in the development and the use of the UDAP statutes[9] around the country. We have seen greater attention paid to the non-disclosure aspects of consumer transactions that are troublesome. I recognize the truth of what Robert Cook has said about Truth in Lending still being used, to some extent, as a cure for what are really not disclosure problems. And I would agree with the call for giving greater attention to what's really wrong with consumer transactions, and trying to deal with those substantive and deception aspects of the transactions directly rather than through disclosure. Nina [Simon] is really on to something in suggesting a new model of disclosure, one that would get the information into consumers hands at a time when the original objectives of Truth in Lending could still be achieved, that is meaningful disclosure and enhancement of competition. Let the market work, make the market work, and to do that I think she's right in suggesting that we need to get essentially all of the costs disclosed up front, the percentage rate disclosure has to encompass all of that and in that kind of environment I think the shopping function may well be achieved. I'm dismayed to hear two panelists say that reform of truth in lending is in one sense not desirable and in another sense not possible. That's really unfortunate. I think it would be really terrific if this group, for example, could try to come together and put on the table a new way of thinking about credit disclosure, a way of folding all of those costs into one disclosable and disclosed figure and present that to Congress for serious amendment or serious revision of Truth in Lending.

Rohner: Let's consider the floor open for questions or comments from anyone, but let me try one of my own in making that handoff. I'm now thinking down at the more mundane level of trying to make disclosures user-friendly. We know of the efforts by the Federal Reserve to do some field testing of the disclosure forms for Regulation M. I don't think the Fed has ever done any kind of equivalent field testing of the Federal Box or other disclosures for Regulation Z. I'd be interested to know whether any creditors do such testing. More broadly, I wonder whether some substantial exercise like that, of trying to look from the bottom up, that is from the consumer's viewpoint upward, rather than from some member of Congress' viewpoint downward, as to what ought to be disclosed to consumers and would be useful to them, whether some effort to assess what kind of information should be disclosed, in what format and at what time, is being done at all and, if not being done, should be. Anybody have a reaction to that? Robert?

Cook: Let me direct that question, more pointedly, to Dick Mossburg, if I could. The Ford Red Carpet Lease got a lot of press during the reformation of Reg M because of the format that Ford adopted independently, which tended to be consumer-oriented. Dick, I was just wondering, did Ford do consumer testing or was it just that the best minds at Ford got together and said this is what we need to do to make this disclosure more effective?

Mossburg: There was some consumer testing in addition, not only consumer but dealer testing, in addition to the best minds at Ford Credit getting together and determining what can be done. But there was a conscious effort to enable the consumer to put the essential pieces in various sections of the contract, to try to be almost three dimensional. We're very happy with the results, but there was a conscious attempt to do that, simply because my client and many other companies around here really do want to give the consumer clear disclosures. We feel hamstrung to a certain degree by the current regime.

Cook: Also the Mortgage Bankers Aassociation now has completed a consumer survey on the meaningfulness of disclosures. I don't think it's quite yet a public release but they've got raw data in.

Rohner: Part of the problem in trying to field test anything or consumer survey test anything under Regulation Z is that to do it in compliance with the current regulation and then field test it doesn't advance the ball very far. I'm going to take a risk and just ask Dolores [Smith] or Adrienne [Hurt][10] whether, to the extent they've thought ahead about the Reg Z review project, whether there's any thought of the Federal Reserve Board doing that kind of customer testing of disclosure techniques?

Dolores Smith: There has been some discussion, although no decision has been made obviously, about the possibility of using focus groups the way we did with Regulation M. Now, in the case of Regulation M, that was the first time we had ever used that particular mechanism. It was useful in that it basically confirmed other information that was already available about the usefulness of the direction that the disclosures were taking. We also periodically use the Michigan Research Center monthly surveys to include questions in addition to the big survey that is done every five years on consumer attitudes and so forth.

Golann: As usual, perfection is the opponent of getting anything done. I remember back in my career as a consumer protector, I was the czar of item pricing. That is, I could decide which items in the entire panoply of things sold in Massachusetts had to have little price tags stuck on them. It was a big headache. But, realizing that nothing in law school had ever prepared me for this, I got the secretaries in the office together and I would make them a little jury and I would say, "Should we put it on eggs?" and they'd

9. *I.e.*, state laws prohibiting "unfair or deceptive acts or practices," generally patterned on the Federal Trade Commission Act.

10. Both are on the staff of Federal Reserve Board.

say, "No, no! Crazy." Then I'd say, "Well, should we put it on frozen foods?" "Nah, it slips off and gets stuck." And so it went. It wasn't a very scientific method, but they did have views that were different from mine and I learned an awful lot, very quickly, without any outside expense and without having to hire a consultant. Actually, I did the same thing when I was trying jury cases, except then I would try it out on my wife, who would point out to me things I really didn't understand about how common people thought. And then I started winning jury cases; it was interesting. [laughter] So, in any case, I just point out that there are simple ways of doing market testing as well as very complex ones. And I think if you just tried it out on a few people you would quickly learn some of the big problems with our current regime.

Keest: Earlier today, an attorney from Alabama was asking how we deal with the disclosure issue with people who are at low literacy levels. It's one thing to have some substantive disclosure, substantive rules, but does anybody here have any good ideas what to do if there are 40% of the people in this country who are functionally illiterate. How do we deal with that as a disclosure issue?

Audience: In the securities markets there is a concept of an investment that's appropriate for the investor. I write these credit disclosures and I can't see somebody with a fourth grade education successfully reading them. Maybe as credit gets more complex there should be, at least in the environment that Nina sees where a broker is marketing the credit to the borrower, a concept of "was this credit appropriate for this particular borrower" and some responsibility for that on the part of the brokers.

Audience: Doesn't that kind of fly in the face of ECOA and the idea that you can't discriminate in a credit transaction, that a creditor is going to decide that someone lacks the capacity, particularly when some of those people may be protected classes?

Audience: We're obviously going to have to take all of that into account if we are going to overhaul credit laws and I don't think you can just overhaul Truth in Lending and fix that problem.

Audience: I think really it goes to the whole notion or underlying premise. I use the same test that Dwight did. I asked my wife, who has the advantage of wonderful directness and bluntness of somebody who works in the medical field, about the whole notion of disclosure. She said, well, if I'm driving down the road and there's a bump in the road, what you're really telling me is that the government has put a sign up there saying "slow down for bump" or "watch out for bump," rather than taking the bump out of the road, which is the underlying premise that really is the heart of this whole debate. It seems to me that the gentleman's comment over there is perfectly appropriate. If you don't want abuses, you either go to some form of limitation on innovation, some kind of standardization, and that happens in all kinds of consumer products. I'm not taking sides on this debate. Or you go to some kind of after the fact review. In the securities cases it's called suitability, and in the insurance industry generally insurance products must meet certain regulatory standards. In all sorts of consumer products and services we provide certain standards, and in effect this is how you get out of the after-the-fact review. A speaker in yesterday's auto leasing panel said that he anticipates seeing a lot more UDAP equity-based challenges to a lot of the emerging kinds of lease products. I think de facto this is what's happening here. We're getting more and more into after-the-fact review, and I think that's inevitable as products become ever more complex, become ever more individualized—unless you want to go to some kind of standardization. For what it's worth, in a parallel area in Switzerland, when you go to buy dried products, like dried potatoes, there are only four sizes that that can be sold, and the government determines what those four sizes are. Now, I'm not advocating that for credit, but it seems to me that that's really the premise that is underlying this whole debate. As Robert Cook says, we're asking Truth in Lending, we're asking disclosure, to take care of problems that it's not designed to take care of.

Rohner: Partly because he has to leave momentarily and partly just as an expression of gratitude for his taking a Saturday to come spend it with us, let me give the last word, or at least the semi-last word to Bob Elliott.

Elliott: I agree that this issue of what to do with people who, once the information is provided to them, cannot or will not make a rational decision as to what to do, is the crux of the problem that I cited in the beginning. What's the difference between disclosure and useful knowledge? I would categorize the problem somewhat differently than the gentleman did. I wouldn't look at us as a bump in the road necessarily but maybe a broader highway where the speed limit is a little faster and you have to exercise some more caution. But whatever metaphor you use for the issue, the outcome is the same. I don't know what you do about an individual who is incapable, and I don't know who gets to make that judgement. I know I can't make that judgement. That's only one problem, and we have all kinds of suitability issues that go to, for example, older people and open-end credit. What's the morality and legality of offering someone who is 80 years old an open-end line of credit and what does the law say about your specifically excluding them from your offers. You're caught on the horns of a dilemma and I'm going to leave right now with it hanging on the horns because I don't know the answer either.

Rohner: Thank you very much, Bob. Dwight, I think we have used up our time, and I hand the meeting back to you.

Golann: I thank the panel for joining us, Bob Elliott and also Kathleen and Nina and Robert and Ralph. This was an interesting discussion.